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Consequences for U.S. and Western Banking System of Financial Embargo against USSR

The explicit financial costs to the United States of pressuring U.S. banks not to undertake further lending to the USSR would depend largely on the Soviet reaction. It is unlikely that the Soviets would retaliate by repudiating their outstanding debt to U.S. banks, and under this assumption the explicit costs to the banks, assuming they complied with USG pressure, would be virtually nil since they would lend the money elsewhere. There would, however, be a substantial adverse but non-quantifiable psychological effect as a result of the reversal of existing U.S. policy not to interfere in the lending decisions of U.S. banks.

A USSR repudiation, if it occurred, would cause direct losses to U.S. banks of about $1/2 billion; their exposure relative to capital is in the one to four percent range (for eight large banks accounting for three-fourths of total claims). However, this act would probably not be confined to USSR debt but encompass most or all the Eastern Europe bloc. The bloc-wide exposure of U.S. banks is around $5 billion, or somewhat more than 10 percent of the aggregate capital of the internationally active U.S. banks -- the precise degree of exposure varies from bank to bank. U.S. banks would thus survive a repudiation, although at no small cost. The USG would absorb part of the cost in the form of tax writeoffs.

It is unlikely that the USSR could or would confine a meaningful repudiation to its debt to U.S. banks. Much of international bank lending is in the form of syndicated credits booked in Euro-currency centers outside the United States whose terms provide for sharing of payments received; even a limited repudiation would create great market uncertainty and bring further lending to the East from non-U.S. banks to a halt. Trade with the West would virtually cease. This probable consequence of repudiation virtually guarantees that the USSR would avoid that step as retaliation for a no lending policy urged by the USG on U.S. banks.*

If a global repudiation were to occur, U.S. banks would also be affected indirectly by the impact on non-U.S. banks. Non-U.S. banks are considerably more involved in lending to the Eastern bloc, particularly to the USSR. Precise data

* Further discussion of the impact of a bloc-wide default is contained in the attached paper (see pp. 4 and 5) prepared for another purpose on the Polish situation.

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are not available because a large portion of banks' claims are guaranteed by their home government, but their non-guaranteed exposure, estimated at roughly $38 billion, is about eight times as large as that of U.S. banks. A number of European banks would probably require substantial assistance, and confidence in the international payments system would be impaired.

The adoption of other sanctions against the USSR would in any event greatly decrease the willingness of U.S. banks to lend to the USSR (and other bloc countries). Indeed, U.S. banks' outstanding loans and commitments to the USSR, and to the bloc generally, have declined by $1.1 billion -- i.e., by 15 percent -- over the past 18 months. Pressure on the banks to cease all new lending would accelerate this trend, although the scope for further reducing outstanding claims is limited by the fact that over half of outstanding claims as of mid-1981 were medium or long term.

Conclusion

Attempting to influence U.S. banks' decisions on lending would undermine the principle that banks are responsible for their decisions and would not be necessary since banks would be highly reluctant to lend in any event given the current circumstances (i.e., the political climate since Afghanistan and the increasing debt servicing difficulties of some East European countries). It is very likely that the specter of even more (non-financial) sanctions will be sufficient to dissuade U.S. banks from undertaking new lending.

Pressuring U.S. banks to halt lending to the USSR would have little effect on the Soviet financial position unless imposed by other Western countries as well. If it impacted multi-national syndicated credits in which U.S. banks are involved as well as bilateral U.S. lending, retaliation in the form of repudiation of debt would probably trigger bloc-wide default to all banks, with substantial losses to U.S. banks, devastating losses to non-U.S. banks, and severe impairment of the international banking system.

Even if the Soviets tried to limit repudiation to bilateral, non-syndicated loans from U.S. banks, the ensuing efforts of U.S. banks to attach Soviet assets could bring world-wide legal actions against the USSR.

Attachment: Potential Impact of the Polish Situation on International Banking System

Treasury/OASIA/IMB
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